



Hiring your child can
help you save big in taxes



As a small business owner, you may have considered hiring your child to help out within your company. Not only does this allow you to instill a strong work ethic in your child, but it also comes with numerous tax advantages. In this document, we'll discuss the key benefits and tips to keep in mind when hiring your child in your business.

Shifting Income and Reducing Taxes

One of the primary financial benefits of hiring your child is the ability to shift some of your highly taxed income into income that is tax-free or at least subject to minimal taxes. You can do this by paying your child a reasonable wage for the services they perform. Your child can then utilize their standard deduction of \$13,850 for 2023 to shelter their income, ultimately reducing your family's overall tax liability.

For example, if you hire your 16-year-old child and pay them \$8,000 a year, they can use their standard deduction to shelter the entire amount. If their earnings exceed the standard deduction, excess earnings will be taxed at your child's lower tax rate, starting at just 10%.

Income Tax Withholding

Your child may be exempt from federal income tax withholdings if they had no federal income tax liability in the previous year and do not expect a tax liability this year.

However, the exemption from withholding cannot be claimed if their income exceeds \$1,250 for 2023 and includes more than \$400 of unearned income, and they can be claimed as a dependent on someone else's tax return. In this case, your child can expect a refund of withholdings depending on their total compensation.



Social Security and Medicare Tax Savings

By hiring your child, you may be able to reduce your FICA and FUTA obligations. You do not have to pay FICA taxes on compensation to your child under age 18 if your business is a sole proprietorship, a single-member LLC, or an LLC taxed as a partnership and owned solely by you and your spouse. Also, if your child is under the age of 21, their compensation is not subject to FUTA.

Unfortunately, there is no FICA or FUTA exemption for hiring your child if your business is incorporated or is a partnership that includes non-parent partners.

Retirement Benefits

Finally, depending on your business structure and retirement plan, you may be able to make a tax-deductible contribution to your child's retirement account, helping to save even more in taxes.



Tips for Hiring Your Child in Your Business

The benefits of hiring your child can be significant, but you must follow the rules.

1. Ensure real work is performed for reasonable pay. Your child's job must be legitimate, and their compensation must be reasonable for their services. You should not pay them significantly more or less than the average wage for similar work in your area.
2. Follow all employment laws and file the required forms. This includes having your child fill out Form W-4 and Form I-9, obtaining an Employer Identification Number, and adhering to child labor laws.
3. Withhold and remit appropriate taxes. Unless they are exempt, you must withhold and remit applicable taxes from their wages. Additionally, you must pay FICA and FUTA depending on your business structure and your child's age.
4. Keep thorough and accurate payroll records for all employees, including your child. Document hours worked, wages earned, and taxes withheld.
5. Pay your child by check or electronic transfer instead of cash to establish a clear payment record. This will help demonstrate that your child genuinely received their wages.
6. Finally, assist your child with filing their tax return. This will help your child become familiar with the tax filing process and potentially receive an income tax refund, depending on their earnings.



Final Thoughts

This document is intended to provide a brief overview and is not a substitute for speaking with one of our expert advisors.

Hiring your child comes with numerous financial benefits, including tax savings and the ability to instill a strong work ethic in your child. However, it's essential to follow all employment laws, file the required forms, and keep accurate payroll records.

If you have any questions or would like to discuss hiring your child in your business with one of our expert advisors, please contact our office.



About Pugh CPAs

We got our start in Knoxville, Tennessee in 1969 and have grown into a regional firm with global connections. We've been in business a LONG time and that means we've worked with a diverse group of industries and clients. Of course, we do tax planning, compliance, auditing, and accounting but our passion is collaborating with our clients to ensure that your business and financial goals are met. It's critical for your business advisors to understand how your business operates within your industry—we get that! Our longevity is connected to the relationships we build with our clients and that's how we build trust. You can be confident that Pugh CPAs has the knowledge, skills and abilities to help you achieve your goals. Brilliant people with servant hearts work here.



Pugh CPAs
315 N Cedar Bluff Rd
Suite 200
Knoxville, TN 37923-4548



(865) 769-0660



info@pughcpas.com



www.pughcpas.com

